

Sent By: OUSD(I)/DIR,CS&P;

703 602 6061;

May-21-01 12:27;

Page 1/3



DEPARTMENT OF DEFENSE
OFFICE OF GENERAL COUNSEL
1600 DEFENSE PENTAGON
WASHINGTON, DC 20301-1600



May 15, 2001

MEMORANDUM FOR DIRECTOR, COMPETITIVE SOURCING AND PRIVATIZATION,
OFFICE OF THE DEPUTY UNDER SECRETARY OF DEFENSE,
INSTALLATIONS

SUBJECT: The 45% Limitation on Investments under 10 U.S.C. 2875

The Military Housing Privatization Initiative (MHPI) authorizes the Secretary of a military department, *inter alia*, to "make investments in an eligible entity carrying out projects for the acquisition or construction of housing units suitable for use as military family housing." 10 U.S.C. 2875(a). When the Secretary conveys land or facilities as part of its investment, the total value of the investment "may not exceed an amount equal to 45 percent of the capital cost (as determined by the Secretary concerned) of the project or projects that the eligible entity proposed to carry out." 10 U.S.C. 2875(c)(1).

You have asked this office for our legal opinion regarding the methodology for calculating the value of the government's investment as a percentage of the total capital cost of the privatization project in order to determine whether the level of Government investment complies with the 45% limitation. Specifically, you ask (1) whether the value of the assets that the Government invests in a limited partnership pursuant to section 2875 of title 10, United States Code, should be included in the capital cost of the project; and (2) what amount properly represents the value of such assets for the purpose of determining the Government's proportionate share of the capital cost of the project. As further explained below, it is the opinion of this office that (1) the adjusted basis of the assets that the Government invests in a limited partnership is properly included in the capital cost of the project; and (2) the Government's basis in those assets properly represents the value of such assets for the purpose of determining the Government's proportionate share of the capital cost of the project.

Capital cost, "with respect to a project for the acquisition or construction of housing, means the total amount of the costs included in the basis of the housing for Federal income tax purposes." 10 U.S.C. 2875(c)(2). Therefore, in order to determine the capital cost of a project, we must answer two questions: (1) What is a "project for the acquisition or construction of housing"; and (2), what costs of that housing are properly "included in the basis of the housing for Federal income tax purposes."

The MHPI defines "a project for the acquisition or construction of housing" as including

OPTIONAL FORM NO. 10 (7-99)

FAX TRANSMITTAL

of pages - 3

To: STEVE KEATING From: Bob Helwig
Dept./Agency Phone #

Fax #

48H 7640.01 817-7000 6000-101 GENERAL SERVICES ADMINISTRATION

ent By: DUSD(I)/DIR,CS&P;

703 602 0001;

May-21-01 12:27;

Page 2/3

not only the construction of new housing units but also "the improvement or rehabilitation of existing units." 10 U.S.C. 2871(3). Accordingly, in the context of a capital cost determination, "a project for the acquisition or construction of housing," refers to the entire project - new construction and existing units.

Having determined that "a project for the acquisition or construction of housing" includes both new construction and existing units, the next step is to determine what costs of that project are properly included in the basis of that project for federal income tax purposes. As a general rule, the "basis of property shall be the cost of such property". 26 U.S.C. 1012. Therefore, whatever the partnership spends to create the project becomes part of its basis in that project. In simple terms, the total development cost of the project is the partnership's basis in the project. If the project were starting from scratch (i.e., all new construction without any contributed assets), this would be the end of the inquiry. However, cost is not the only component of basis when a partner contributes assets to the partnership and those assets are part of the project that the partnership will undertake.

When a partner contributes assets to a partnership, the partnership's basis in those assets is "the adjusted basis of such property to the contributing partner at the time of the contribution" 26 U.S.C. 723. The Government's adjusted basis in property under its control would be the initial "cost of such property", 26 U.S.C. 1012, plus any other "expenditures . . . properly chargeable to capital account" and less depreciation. 26 U.S.C. 1016. This amount is generally represented by the depreciated book value or current plant value that the military department maintains with respect to real property under its control. Consequently, in addition to the costs that the partnership expends in development of the assets and creation of new assets, the basis of the project, and therefore the capital cost of the project, must also include the adjusted basis of the assets contributed by the Government at the time of the contribution.

In addition to your question regarding capital cost, you also asked us to determine what amount represents the "value" of the Government's contribution for the purpose of determining the Government's proportionate share of the capital cost of the project. The fact that Congress imposed a statutory percentage limitation, as opposed to a strict dollar amount limitation, on the amount of the Government's investment under section 2875, indicates a clear congressional purpose to measure the proportionate contribution of the Federal Government to the whole project. It is the opinion of this office that in order to effectuate that clear congressional purpose, the amount included in the numerator to determine the percentage contribution by the Government should be the same amount as that added to the denominator to reflect the Government's contribution when calculating total capital costs. Since the amount added to the denominator is statutorily established as the adjusted basis of the contributed assets, the "value" of the federal contribution must also be the adjusted basis of the contributed assets.

In conclusion, when the Government conveys land or facilities as a part of its investment under 10 U.S.C. 2875, and those assets are part of the project that the partnership will undertake, the adjusted basis of those assets is properly included in the capital cost of the project. Furthermore, the Government's basis in those assets properly represents the value of such assets

9-07-2001 2:06PM

FROM BBP ASSOCIATES 410 266 7866

P. 4

sent By: DUSD(I)/DIR,CS&P;

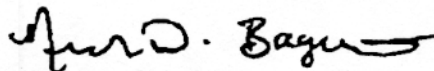
703 602 6061;

May-21-01 12:27;

Page 3/3

for the purpose of determining the Government's proportionate share of the capital cost of the project.

If you have any further questions on this matter, feel free to contact me at 703-693-4842.



Nicole D. Bayert
Associate General Counsel
(Environment & Installations)